

HUMAN RESOURCES BULLETIN 98-2

New Federal Income Tax Rules for Annuities Commencing After December 31, 1997

Section 1975 of the Public Law 105-34, the Taxpayer Relief Act of 1997, enacted August 5, 1997, amended section 72(d) of the Internal Revenue Code to change the "simplified general rule" for determining the tax-free portion of an annuity. The change applies only to annuities that begin after December 31, 1997, and that are "payable over the lives of more than one individual," i.e., those with a survivor's annuity.

The Simplified General Rule is as follows: For annuities that begin on or after July 2, 1986, a portion of each monthly annuity payment is a tax-free return of the annuitant's retirement contributions. To determine how much of his or her monthly annuity payment is tax free, the annuitant divides his or her total retirement contributions by the total number of anticipated monthly payments that will have a tax-free component. This number is found in a table in 26 U.S.C., section 72(d), and is based on the annuitant's age at retirement.

The changes made by the Taxpayer Relief Act are as follows: Section 1075 of the Taxpayer Relief Act provides that for annuities beginning after December 31, 1997, there are now two tables for determining how many monthly payments have a tax-free component. Employees who retired after July 2, 1986 and before December 31, 1997 or employees who retire after December 31, 1997, but have no survivors will still use the current tax table. The change is only for employees who retire after December 31, 1997, and who have a survivor.

The taxpayer Relief Act of 1997 creates a new table for figuring the tax-free amount if a survivor annuity has been provided. The table is based on combined ages of the annuitant and the person for whom the survivor annuity has been provided. The table follows:

| If the combined ages of annuitants are: | The number is: |
|--|-----------------------|
| Not more than 110 | 410 |
| More than 110 but not more than 120 | 360 |
| More than 120 but not more than 130 | 310 |
| More than 130 but not more than 140 | 260 |
| More than 140 | 210 |

The Office of Personnel Management has asked the Internal Revenue Service (IRS) to address several points that the change in law does not specifically cover. These include how to handle cases in which survivor benefits may be payable to more than one person (such as a spouse and former spouse), what (if anything) a retiree should do if his or her marital status changes after retirement, and whether insurable interest elections are treated the same as elections to provide benefits for spouses.

The IRS is updating Publication 721 "Tax Guide to U.S. Civil Service Retirement Benefits."

IRS Publications can be requested by calling 1-800-TAX-FORM or by visiting the IRS internet site at <http://www.irs.ustreas.gov>.

(Source of information: Office of Personnel Management Benefits Administration Letter 97-113)

WILLIAM D. ST. JOHN
Director of Human Resources